UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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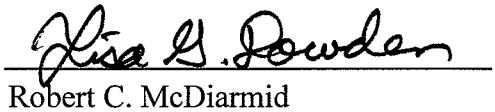
| Market Based Rates for Public Utilities | Docket No. RM04-7-000 |

**WRITTEN STATEMENT OF TERRY HUVAL ON BEHALF OF THE LAFAYETTE UTILITIES SYSTEM AND THE TRANSMISSION ACCESS POLICY STUDY GROUP**

The Lafayette Utilities System ("Lafayette") and the Transmission Access Policy Study Group ("TAPS") herein file the written statement of Mr. Terry Huval, Director of Utilities at Lafayette, which he delivered at the Commission's Technical Conference in the above-captioned docket on January 28, 2005. Lafayette and TAPS expect to file additional post-technical conference comments during the process indicated by the Commission Staff. Please contact the undersigned with any questions.

Respectfully submitted,



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My name is Terry Huval, and I am the Director of Utilities of the Lafayette Utilities System ("Lafayette") which serves the City of Lafayette, Louisiana. I am also speaking today on behalf of the Transmission Access Policy Study Group ("TAPS"), of which Lafayette is a member. Thank you for the opportunity to participate in this important technical conference.

## I. LAFAYETTE AND TAPS

Lafayette is a 108 year old municipally-owned electric utility serving the city of Lafayette. It constructed, operates and maintains its entire transmission and distribution system and all generation resources within the City. Lafayette operates its own control area. Lafayette has a 50% ownership in the Rodemacher Coal Unit in Boyce, LA which is some 100 miles north of Lafayette. The other owners of this unit are CLECO (30%) and the Louisiana Energy and Power Authority ("LEPA") (20%). The Lafayette transmission system consists of 230 kV and 69 kV facilities and 138 kV ring bus which have numerous interconnections with CLECO and Entergy. In fact, the Lafayette system is the single largest interconnection between the Entergy and CLECO systems. A review of power flows through those transmission facilities indicates that Lafayette's transmission system experiences significant flows in support of Entergy and CLECO's ability to serve both their native retail loads and their wholesale loads. As a result of this

physical connectivity, flow shifts on the Entergy and CLECO systems can have a considerable impact on the Lafayette system.

Lafayette believes that Entergy's failure to build and maintain a strong transmission system may facilitate affiliate creation and preference. Real or artificial transmission limitations discourage robust competition because buyers are unable to access more economical generation sources. This under-investment is a form of transmission market power, which is used to keep lower-priced supplies out of the market, making affiliate creation and preferences profitable for the vertically integrated transmission owner. It harms consumers who face higher prices, and competitors who are cut off from access to willing buyers.

TAPS is an informal association of transmission dependent utilities ("TDUs") in more than 30 states (including Louisiana), promoting open and non-discriminatory transmission access. TAPS has long recognized the critical importance of truly non-discriminatory open access to TAPS members' ability to access competitive supplies and to provide reliable service to their customers at a reasonable, predictable cost, as well as to achieve the Commission's pro-competitive objectives.

## II. LAFAYETTE'S FUNDAMENTAL CONCERNS

I am not a lawyer or an economist, and I am not in a position to analyze the Commission's rules on affiliate abuse. I am here to present instances of real-life obstacles my utility faces in its planning and daily operations that result from a weak, constrained and long neglected Entergy transmission system, and the implications for Entergy's ability to create and prefer affiliates, and its own generation. As a transmission owner, as well as a TDU, I know what it takes to maintain a robust transmission system

and I can tell you that it has become increasingly obvious that Entergy has been starving its system. The lack of access over this system for Entergy competitors, including Lafayette, allows and encourages Entergy to increase its generation market dominance and creates opportunities for it to create and favor its own affiliates or its own generation. Specifically, lack of access to transmission, notwithstanding Entergy's open access transmission tariff ("OATT"), raises the following problems, each of which is discussed in greater detail in the next section:

- Lafayette cannot make use of its own economic generation, for which it has reserved and paid for firm transmission, due to curtailments necessitated by overloads on the Entergy system.
- Although Entergy claims that approximately 17,000 MW of new, Independent Power Producer ("IPP") merchant generation have been added on its system over the last 4 years,[1] Lafayette has not been able to access meaningful amounts of that generation to offset higher cost resources, because transmission is not available. By not upgrading the transmission system, Entergy has made the IPPs captive to Entergy.
- Despite the 17,000 MW of IPP generation on the Entergy system, Lafayette is building new generation in Lafayette rather than purchasing power on the open market, because it cannot get transmission access to those existing plants, despite attractive prices. Again, Lafayette

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[1] *See, e.g.,* January 18, 2005 Request for Rehearing of Entergy Services, Inc. in *Entergy Services Inc.*, Docket Nos. ER03-1227-000 and EL05-22-000 at p.5; *Entergy Services, Inc.*, 104 F.E.R.C. ¶ 61,336 (2003) at 3.

consumers must pay more due to Entergy's successful strategy to strangle transmission capacity in this area.

- Entergy conducts a weekly procurement process ("WPP") auction for generation, to supply Entergy's own needs. Lafayette and other potential buyers cannot participate in or obtain access to this auction (in which the transmission of the successful bid is accomplished by redispatch of Entergy generation if necessary). However, because the generators cannot access other buyers through the auction, Entergy obtains the power at bargain basement prices.
- When the IPPs get low prices for their power in the Entergy single buyer auction, they are unable to make their debt service, and suffer significant financial hardships, which in some cases has resulted in IPPs declaring bankruptcy. This enables Entergy to purchase the generation at fire sale prices, further increasing its generation dominance. Once Entergy has acquired the IPP, it can roll into its rates to all its customers the costs of the long-needed transmission reinforcement to enhance its ability to profitably use the generation.
- This, apparently, is Entergy's competitive strategy, and it's all too successful, giving it increased market power.

## III. DETAILED DISCUSSIONS

Lafayette believes that Entergy has starved the Entergy transmission system of investment, and allowed situations to develop on its grid that increase congestion, foreclose independent suppliers from accessing any customer other than Entergy, and

export adverse impacts onto neighboring utility systems such as those of Lafayette and CLECO. The examples below make Entergy's low investment, high-congestion strategy even more clear.

### *A. Uncompensated Redispatch and Inability to Access Lafayette Resources*

Lafayette has previously noted for the Commission[2] its increasing difficulty accessing power from its owned share of the Rodemacher coal plant, for which it has reserved firm transmission service over the CLECO system.[3] However, because of conditions on the Entergy system, Lafayette has been faced with repeated and increasing demands[4] that it back down its Rodemacher power output and bring up more expensive peaking units in Lafayette in order to solve congestion problems on the Entergy system that generate calls for Transmission Loading Relief ("TLR") curtailments. When these curtailments have occurred, Lafayette customers must pay more to run its expensive peaking generation to serve Lafayette native load customers, even though it is Entergy that needs the change to reliably serve its own loads. Lafayette receives no compensation for these repeated redispatch demands. Although Entergy claims that it must also redispatch its generation units during such transmission curtailments, there is no independent market monitor or grid operator who can confirm that this is the case.

Moreover, Entergy is well aware that the financial impact for Lafayette to redispatch its generation units is several orders of magnitude greater than the financial

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[2] *See e.g., Entergy Services, Inc.*, 109 F.E.R.C. ¶ 61,281 (2004) at 39.

[3] Lafayette arranged this transmission service when it purchased its share of the unit in 1979 and pays CLECO approximately $4.5 million a year for this service that is denoted "firm".

[4] Though the requests often come through the Southwest Power Pool ("SPP"), we understand that they are initiated by Entergy calls on SPP.

impact to Entergy.[5] Due to the electric connectivity between the Entergy and CLECO systems, and the location of the specific overloads on the Entergy system, the only generation that can relieve the more common Entergy system problems are generation units owned by Lafayette and CLECO. In Lafayette's case, the cost of power from the units it must use to relieve these Entergy system overloads is nearly 4 times greater than the Rodemacher unit, whose power Lafayette must curtail during these overloads. The TLR declarations have increased in frequency from 4 in 2002, to 48 in 2003, to 76 in 2004. The resultant increased cost to Lafayette's 55,000 retail customers is estimated to have been at least $1.5 million over the past 2 years. One of the main reasons for the increased TLR calls Lafayette has experienced was Entergy's interconnection of the Acadia Project. The Acadia Project, a CLECO/Calpine venture consisting of gas-fired CTs interconnected at the Richard Substation (an interconnection point between CLECO and Entergy), was, of course, interconnected with the Entergy system only after study. Much later, Entergy admitted in a meeting with Lafayette that as part of its assumptions for the interconnection study for that plant, Entergy modeled Lafayette's internal gas-fired Doc Bonin peaking units as running around the clock, even though Lafayette has not used the Bonin units in this manner since the Rodemacher coal unit came on line in 1979. The Bonin units are generally used only in extremely hot or cold weather. Entergy simply assumed that Lafayette's units could be called upon, without compensation, whenever Entergy desired Lafayette to do so. Lafayette was never consulted about any of these studies, or about the interconnection of the Acadia plant, or informed of Entergy's assumptions until the meeting referenced above, on December 19, 2003, long

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[5] The cost of energy from Rodemacher is about $20 MWh. For the Bonin plant it is about $75 MWh.

after Entergy interconnected the plant. Lafayette does not know what type of interconnection study the Acadia Project sought, or what representations were made to it as to transmission availability. But given Entergy's use of invalid study assumptions here, one must wonder if some of the now-struggling IPPs relied on Entergy studies to their detriment.

Although transmission upgrades that should largely resolve the TLR issue are now under construction and scheduled to be placed in operation by the 2005 summer peak, those upgrades, largely financed by CLECO, were developed to resolve issues on the CLECO system and to facilitate the purchases by both Entergy and CLECO from the Acadia Plant. Specifically, the upgrade makes it possible for CLECO to purchase 500 MW of low heat rate, combined cycled electric power from the plant. It is anticipated that Entergy will experience similar benefits due to this upgrade.[6] In essence, this upgrade, while providing benefits to the grid, will also provide significant operational flexibility and financial benefit to both CLECO and Entergy.

Lafayette assumes that both CLECO and Entergy will seek to roll their costs for these upgrades into their respective transmission rates, and Lafayette does not dispute this treatment. However, if the two companies had not decided that they needed these upgrades to serve their own system needs, Entergy was apparently willing to continue leaning on CLECO and Lafayette, without compensation, for so long as it could get away with doing so. So long as vertically-integrated systems can export their transmission

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[6] The benefits include avoiding threatened litigation surrounding the interconnection of the plant with insufficient transmission access.

problems to their neighbors, utilities can use their weakened grids to favor their own operations.

### *B. Lafayette is building new units because it cannot access existing IPP generation*

Despite the excess IPP generation in which Entergy claims its system is awash, Lafayette is building new combustion turbine units ("CTs") in its own service territory, because it simply cannot count on obtaining transmission capacity over the Entergy or CLECO systems to purchase attractively priced generation located nearby. For example, prior to committing to build the new CTs, Lafayette considered other options, including acquiring a financially troubled NRG plant in Bayou Cove, only 40 miles away. Unfortunately, Lafayette's transmission studies showed that delivery of the NRG power would still be subject to curtailments in Entergy's frequent TLR situations, and Lafayette concluded that there was no point in even submitting a transmission request.

### *C. Lack of access to the WPP*

Because the Entergy Weekly Procurement Process ("WPP") serves only Entergy's needs, suppliers, attracted by Entergy's far greater needs, will bid their capacity into that auction. Lafayette is thus not only barred from the WPP, but those sellers who participate in WPP cannot offer the capacity elsewhere until they know the results of the WPP. And, of course, there would still be the problem of getting transmission for any individual sale to Lafayette, while winning WPP bids receive transmission service to deliver to Entergy loads (Entergy backs down more expensive

generation to accomplish this).[7] Entergy thus soaks up this capability on its own system, while providing no access to regional markets.

Because Entergy is the only buyer in the WPP energy market, Entergy effectively gets the value of the IPP generation (especially knowing that sellers are unlikely to be able to sell to anyone else if Entergy does not select them in the WPP) without contracting for the capacity. This structure keeps Entergy's purchased power costs low, but it also causes financial problems for the IPPs, some of whom have been unable to service their debts on the units and have entered bankruptcy or restructuring. Without adequate recovery, the units must often be sold off cheaply—and Entergy is a willing buyer for such financially distressed units.

### *D. Lack of access to informal energy markets*

Without access to the WPP, Lafayette must make what deals it can individually, and then obtain transmission access to implement them. This is by no means easy. A review of the 2359 transmission requests for service to or from the Lafayette control area that Lafayette submitted to Entergy through its agent, The Energy Authority ("TEA"), between January 2002 and January 2005 reveals that only slightly more than half were fulfilled.[8] During the many instances when Lafayette cannot get transmission, it is forced to rely on more expensive units that do not need transmission to serve its loads.

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[7] *See Entergy Services, Inc.*, 104 F.E.R.C. ¶ 61,226 (2003) and Entergy's Petition for Declaratory Order therein, for a description of the WPP process.

[8] 1209 of 2359 requests were accepted and confirmed. The numbers may be off by about 4% due to multiple requests.

### *E. Perryville*

The Perryville plant is an example of a distressed IPP that had trouble accessing the markets, and is now being acquired by Entergy. There has been much speculation about the Perryville 725 MW natural gas fired plant, which was most recently owned by a CLECO subsidiary, and is presently being acquired by Entergy. According to published reports, the unit was built in 2002 for $336 million and will be sold to Entergy for $170 million.[9] Apparently, the plant has been unable to qualify as a long term firm network resource due to congestion on Entergy-owned transmission facilities in the Monroe area. Entergy says, however, that it can get the transmission it needs on a short term basis, including through possible displacement or delisting of other Entergy generation. Interestingly, as part of the deal to purchase the plant for about fifty cents on the dollar, Entergy has confirmed to the Louisiana PSC that it now intends to make the necessary upgrades to allow the plant greater access to transmission. Lafayette expects that the upgrades will be rolled into the Entergy system transmission rate.

### *F. Entergy's actions increase its market dominance*

The Perryville example is even more troubling to the extent that it may represent an Entergy strategy to starve merchant plants of transmission and then to acquire them at cheap prices. In testimony filed with the House Committee on Energy and Commerce on March 13, 2003 by Christine Tezak, an electric utility analyst with Schwab Capital Markets Group,[10] Ms. Tezak highlighted the conflicting stories analysts are hearing from utilities and IPP owners.

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[9] *Power Week*, January 19, 2004 and February 9, 2004.

[10] http://energycommerce.house.gov/108/hearings/03132003hearing818/tezak1360.html.

> [I]nvestors are confronted with the following conundrum. In the southeast, for example, incumbent utilities' CEOs have begun bragging to Wall Street about their plans to buy assets presently owned by financially distressed independent power producers and put them into rate base. It is interesting for investors, who are familiar with the business plans of both types of participants, that the independent generation assets when owned by an independent can't seem to get transmission capacity to move power today, yet these same assets are being touted as a productive part of an incumbent-owned portfolio. Where should dollars be invested – which story is the truth?

Entergy's own 2002 Annual Report highlighted the capital reserves it has available "to take advantage of market opportunities as others run into trouble" with plants in need of new operators.[11] Recent Entergy presentations to financial analysts confirm that taking advantage of distressed IPP plants remains a key component of Entergy's overall strategy. However, it is one thing for Entergy to take advantage of opportunities created by financially distressed IPPs in its control area. It is another, more serious thing where Entergy is in a position to contribute to that financial distress by preventing the IPPs from obtaining transmission access to get their power to market. So long as Entergy alone operates its grid, there can be no assurance that such abuses are not occurring.

## IV. SOLUTIONS

Because of inadequate transmisison infrastructure, generators looking to sell cannot access willing buyers, and load-serving entities looking to purchase cannot access willing sellers. Generators have few to no potential customers if the vertically-integrated

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[11] Letter to stockholders: http://www.entergy.com/content/investor/htlonly/2002ar/letter.htm.

transmission owner chooses to buy from affiliated generation or to acquire its own plants. Transmission sufficient to allow willing buyers and sellers to contract economically is an obvious and effective solution to these market power problems and the potential for affiliate preferences.[12] In support of this goal, the Commission has a number of policy options.

- The Commission must deny market-based rates to transmission owners whose grids are insufficient to support meaningful access. Transmission owners cannot simultaneously enjoy the benefits of market-based rates while still operating their systems in a way that limits competition.
- The Commission should tie approval of market-based rates to the demonstrated willingness of vertically-integrated transmission owners to jointly plan, on a regional basis, with their network customers and neighboring TDUs, and to permit such entities to invest in the transmission system on a comparable basis. A robust transmission system will dilute the transmission provider's incentive and ability to engage in affiliate preferences.
- The Commission must encourage transmission upgrades to be built, through the inclusive models outlined in the TAPS White Paper, "Effective Solutions for Getting Needed Transmission Built at Reasonable Cost" (TAPS White Paper, June 2004).[13]

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[12] *See* July 1, 2004 Comments of TAPS in *Solicitation Processes for Public Utilities,* Docket No. PL04-6 and *Acquisition and Disposition of Merchant Generation Assets by Public Utilities*, Docket No. PL04-9.

[13] TAPS White Paper, *available at* http://www.tapsgroup.org/sitebuildercontent/sitebuilderfiles/effectivesolutions.pdf (last viewed January 21,

- While Lafayette and TAPS both support the remedies listed above, it is important for the Commission to understand that if remedies are limited to relief for a transmission provider's embedded network customers, they will not be sufficient for Lafayette. Lafayette has its own control area, and is not an Entergy network customer. Lafayette is a neighboring TDU and its problems stem from conditions on the Entergy system that adversely impact Lafayette and Entergy's other neighbors. As long as Entergy can operate without regard to such impacts, change is unlikely. Lafayette believes that the only solution is regional planning and regional control of transmission access and construction. For that reason, Lafayette urges the Commission to require vertically-integrated utilities such as Entergy to join a Regional Transmission Organization (for instance, the Southwest Power Pool) to reduce the opportunities for the utility to favor itself through use of the constrained nature of its transmission system. Only regional transmission control, planning and construction will address the transmission problems the inadequate Entergy system inflicts on its neighbors.

## V. CONCLUSION

Thank you for the opportunity to present the perspectives of Lafayette and TAPS on these issues. I look forward to your questions.

January 28, 2005

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